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FISCAL IMPACT STATEMENT

LS 6286

BILL NUMBER: SB 115

NOTE PREPARED: Dec 2, 2005

BILL AMENDED:

SUBJECT: Probate, Trust, and Inheritance Tax Matters.

FIRST AUTHOR: Sen. Zakas

BILL STATUS: As Introduced

FIRST SPONSOR:

FUNDS AFFECTED: X GENERAL
X DEDICATED
FEDERAL

IMPACT: State & Local

Summary of Legislation: *Revocable Trusts:* The bill provides that a trust is entitled to certain property tax deductions for real property owned by the trust if the property is occupied by an individual who has a beneficial interest in the trust, is considered to have a life estate in the real property, and otherwise qualifies for the deduction. It also provides that the trustee of a trust to which an interest in real property is transferred is considered the insured owner under a title insurance policy issued for the interest in real property if the transfer meets certain conditions.

Inheritance Tax: The bill removes a provision that prevents individuals who are adopted as adults after June 30, 2004, from being considered Class A transferees for purposes of the Inheritance Tax.

The bill increases the Class B transferee Inheritance Tax exemption amount from \$500 to \$20,000 and the Class C transferee Inheritance Tax exemption amount from \$100 to \$10,000.

The bill increases from \$1,000 to \$5,000, for purposes of the Inheritance Tax, the maximum amount that may be deducted from the value of property interests transferred by a resident decedent for the purchase of a memorial to the decedent.

Small Estates: The bill increases the maximum gross value of a probate estate that may be settled without court administration from \$25,000 to \$50,000. It also provides that a claimant seeking payment of a debt owed to a decedent or seeking to obtain personal property or an instrument evidencing a debt, an obligation, a stock, or a chose in action belonging to the decedent must include in the affidavit that the claimant submits to the debtor or person possessing the personal property or instrument: (1) the name and address of each other person

entitled to a share of the property; and (2) a statement that the claimant has notified each other person identified in the affidavit of the claimant's intention to present the affidavit.

(The introduced version of this bill was prepared by the Probate Code Study Commission.)

Effective Date: July 1, 2005 (retroactive); July 1, 2006.

Summary of Net State Impact: The annual net fiscal impact to the state General Fund from Inheritance Tax changes proposed in the bill is summarized in the table below. Under the bill, Indiana Inheritance Tax revenues will decrease beginning in FY 2008. The bill is expected to increase state General Fund expenditures on county Inheritance Tax replacement.

Inheritance Tax Revenues	Add'l. State Expenditures for County Replacement	Net Increase (Decrease)
(\$13.7 M - \$13.9 M)	(\$0.09 M)	(\$13.8 - \$14.0 M)

Explanation of State Expenditures: *County Inheritance Tax Replacement:* The bill could potentially increase expenditures from the state General Fund for county Inheritance Tax replacement to the extent that the Inheritance Tax changes made by the bill cause county Inheritance Tax collections to fall below the current guarantee level.

The impact of extending Class A transferee status to certain adult adoptees is indeterminable. In addition, it is estimated that the increase in the memorial deduction likely would not lead to any increase in expenditures from the state General Fund for county Inheritance Tax replacement. However, the increase in the exemptions for Class B and Class C transferees could potentially increase replacement expenditures by approximately \$90,000 annually beginning in FY 2008. Necessary replacement funding may vary depending on whether, and by how much, each county's base revenue differs from the amount guaranteed under current statute. (See *Explanation of Local Revenues*, below, for an explanation of county revenue loss and replacement procedures.)

Explanation of State Revenues: *Revocable Trusts:* The state levies a small tax rate for the State Fair and State Forestry that applies to all AV. If property is not a part of the tax base, the state cannot assess this tax on the property. Any decrease in the AV base resulting from additional aged, blind/disabled, and veterans deductions granted due to this bill would decrease the property tax revenue for these two funds. However, the potential revenue loss due to the bill is indeterminable.

Inheritance Tax: The bill makes three changes relating to the Inheritance Tax. The changes and potential state fiscal impact are described below.

(1) The bill extends Class A transferee status to certain adult adoptees, increasing their exemption from \$100 to \$100,000. This could potentially reduce revenue from the Inheritance Tax, but the potential reduction is indeterminable. Due to the retroactive effective date (applicable to estates of decedents who die on or after July 1, 2005), any impact resulting from this bill could potentially begin in FY 2007.

(2) The bill increases the Class B transferee exemption from \$500 to \$20,000 and the Class C transferee exemption from \$100 to \$10,000. The exemption changes apply to transfers from persons who die after June

30, 2006. It is estimated that the exemption increases could potentially reduce Inheritance Tax revenue by approximately \$13.4 M annually beginning in FY 2008.

(3) The bill increases the maximum allowable deduction for a decedent's memorial expenses from \$1,000 to \$5,000 for estates of decedents who die after June 30, 2006. The deduction increase could potentially reduce Inheritance Tax revenue to the state by \$250,000 to \$497,000 annually beginning in FY 2008.

Small Estates: The increase in the small estates threshold could result in an indeterminable reduction in court cost fees paid for filing probate cases. Current statute imposes a \$120 fee for court costs relating to filing of a probate case. Under current statute, 70% of the fees are distributed to the state General Fund, 27% are distributed to the county general fund, and 3% is distributed to cities and towns maintaining law enforcement agencies that prosecute at least 50% of its ordinance violations in a circuit, superior, county, or municipal court.

Background Information: Adult Adoptee Provisions: Current law provides a \$100,000 exemption under the Inheritance Tax for Class A transferees - lineal descendants, lineal ancestors, stepchildren, and legally adopted children of a decedent. The latter includes an individual who was totally emancipated at the time of the adoption provided the adoption was finalized before July 1, 2004. The bill eliminates the cut-off date so that totally emancipated individuals adopted on or after July 1, 2004, would qualify for the Class A exemption of \$100,000. The change applies to estates of decedents who die after June 30, 2005.

Class B and C Transferee Exemptions: Under current statute, Class B transferees include the sister, brother, niece, nephew, daughter-in-law, or son-in-law of a decedent. Class C transferees include the aunt or uncle of a decedent; or any other transferee not in Class A or Class B. The exemption changes apply to transfers from persons who die after June 30, 2006.

The estimated impact of the exemption changes is based on the Office of Fiscal and Management Analysis (OFMA) Inheritance Tax database and the Revenue Technical Committee's FY 2007 forecast (published April 11, 2005). The forecast estimates FY 2007 Inheritance Tax at \$120.0 M. The estimated revenue loss assumes that Inheritance Tax revenues would remain relatively constant after FY 2007 absent the exemption. The Inheritance Tax database is comprised of about 209,000 records of transferees receiving assets from a decedent who died between July 1, 1997, and September 30, 2003. Annual sample totals suggest that Class B transferees account for about 33.8% of annual Inheritance Tax revenue (about \$40.5 M of the forecast amount); and Class C transferees account for about 25.8% of revenue (about \$31.0 M of the forecast amount). About 99.4% of total Inheritance Tax collections are from Indiana residents. Since counties retain 8% of resident Inheritance Tax, annual county collections from Class B and Class C transferees are estimated to total about \$3.5 M and \$2.7 M respectively. Simulations with the sample returns suggest that the exemption increases could reduce revenue from Class B transferees by about 21.8% and from Class C transferees by about 14.9%.

Memorial Deduction: Under current statute, the cost of a memorial for a decedent is deductible from the taxable value of property interests transferred by a decedent to his or her transferees. Currently, the deduction is limited to \$1,000. The increase to \$5,000 applies to estates of decedents who die after June 30, 2006. The estimated impact of the memorial deduction increase assumes that an average of 9,500 estates file Inheritance Tax returns annually and that the average expenditure on a memorial ranges from about \$2,000 to \$3,000. Based on this range, estates would, on average, be claiming an additional \$1,000 to \$2,000 under this deduction. The fiscal impact is also based on a 3.1% average Inheritance Tax rate estimated for Class A, B, and C transferees. It also accounts for tax-exempt transfers to surviving spouses and charities estimated to represent about 9% of

transferees.

The Inheritance Tax does not have to be paid until a maximum of 12 months after the decedent's death (within 9 months of the date of death to receive the 5% early payment discount). Therefore, the fiscal impact of Inheritance Tax changes likely will lag the effective date by 9 to 12 months. Under current statute, 92% of resident Inheritance Tax revenue and 100% of nonresident Inheritance Tax revenue is distributed to the state General Fund.

Explanation of Local Expenditures:

Explanation of Local Revenues: *Revocable Trusts:* The bill could potentially lead to additional aged, blind/disabled, and veterans deductions being granted. However, the total amount of these additional deductions is indeterminable. The additional deductions would serve to shift part of the property tax burden from the taxpayers receiving the deduction to all taxpayers in the form of an increased tax rate.

Background Information: The bill provides that a trust is entitled to the aged, blind/disabled, and veterans property tax deductions for real property it owns, provided the property is occupied by an individual and the county auditor determines that the individual: (1) has a beneficial interest in the trust; (2) otherwise qualifies for the deductions; and (3) would be considered the owner of the property under the property tax law.

County Inheritance Tax: The net impact on counties of the Inheritance Tax changes is summarized in the table below.

	Annual Impact Beginning in FY 2008
County Share of Inheritance Tax Revenues (Decrease)	(\$1.2 M)
State Expenditures for County Replacement	0.09 M
Net Increase (Decrease)	(1.1 M)

The extension of Class A transferee status to certain adult adoptees could potentially reduce Inheritance Tax revenue flowing to counties, but the precise impact is indeterminable. It is estimated that the increase in the memorial deduction could potentially result in an annual revenue loss to counties totaling \$20,000 to \$43,000 statewide beginning in FY 2008. This change is not expected to trigger additional Inheritance Tax replacement payments from the state General Fund. The increase in the Class B and Class C transferee exemptions could potentially result in a decrease in revenue to the counties of about \$1.2 M annually beginning in FY 2008. This change is expected to trigger replacement payments totaling about \$90,000 annually.

Background Information: Counties retain 8% of the Inheritance Tax collected on transfers made by Indiana residents. Counties are guaranteed a statutorily determined amount under the replacement provision established by P.L. 254-1997. The replacement provision was established to replace county Inheritance Tax revenue lost when the Class A exemption was increased on July 1, 1997. The replacement provision guarantees that each county receives Inheritance Tax revenue equal to the five-year annual average amount of Inheritance Tax received by that county from FY 1991 to FY 1997 excluding the highest and lowest years. The total annual guarantee to counties is \$7.4 M. Currently, most counties retain more in Inheritance Tax revenues than is guaranteed under the replacement procedure.

A copy of the spreadsheet showing the amount of Inheritance Tax replacement guaranteed to each county under P.L. 254-1997 is available from the Office of Fiscal and Management Analysis.

Small Estates: See *Explanation of State Revenues*.

State Agencies Affected: Department of Local Government Finance; Department of State Revenue.

Local Agencies Affected: Counties, cities, and towns; County Auditors.

Information Sources: State Revenue Forecast (April 11, 2005). OFMA Inheritance Tax database. Department of State Revenue, *Quarterly Inheritance Tax Reports*. Tony Caldwell, President, Indiana Affiliate of Monument Builders of America/Owner, Caldwell Monument Company, Kokomo, (765) 459-8480. Wisconsin Department of Agriculture, Trade, and Consumer Protection, *Planning a Funeral*, (608) 224-5058.

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